



## Kentucky Law Journal

Volume 60 | Issue 1

Article 5

1971

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### Recommended Citation

Murrell, Laura L. (1971) "The Uniform Consumer Credit Code: Changes It Would Make in Kentucky Law," *Kentucky Law Journal*: Vol. 60 : Iss. 1 , Article 5.  
Available at: <https://uknowledge.uky.edu/klj/vol60/iss1/5>

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# The Uniform Consumer Credit Code: Changes It Would Make in Kentucky Law

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The Uniform Consumer Credit Code has been widely touted as the answer to most of the ills in the Consumer Credit area. Nevertheless, various consumer groups, including the Consumer Federation of America, have opposed adoption of the Code. The Consumer Law center at Boston College, a part of the Office of Economic Opportunity legal services system, has proposed an alternative code, the National Consumer Act, which it represents as a real consumer protection code.<sup>1</sup> The reason for this divergence of views can be easily understood through a quick summary of the code provisions.

The UCCC does provide at least a partial answer to many consumer problems that have been the subject of much discussion. There is a provision that would eliminate waiver of defenses and the consequent holder-in-due course problem;<sup>2</sup> however, there is an alternative provision that would only limit it.<sup>3</sup> There is a cooling-off-period provision on home solicitation sales.<sup>4</sup> There

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The opinions expressed in this article reflect solely the view of the author and may not represent the positions or policy of the Office of the Attorney General.

<sup>1</sup> Turner, *The UCCC: A Credit Code for Business*, 60 Ky. L.J. 49 (1971).

<sup>2</sup> UNIFORM CONSUMER CREDIT CODE § 2.404 alt. A [hereinafter cited as U.C.C.C.]. The holder in due course problem results when the seller transfers the contract to a third party. If the goods are defective, the purchaser must still make his payments to the third party and bring a separate action against the seller, if the seller can be found. Since most consumer transactions involve relatively small expenditures, the consumer cannot afford an attorney to bring suit.

<sup>3</sup> U.C.C.C. § 240 alt. B.

<sup>4</sup> U.C.C.C. §§ 2.501-.505. This would take care of the continuing problem of the high pressure door-to-door salesman who talks a family into buying an item they realize they can't afford the next day.

are limitations on the collateral that may be taken in connection with a consumer credit sale<sup>5</sup> and limitations on the practice of repossessing an item and also getting a default judgment in connection with a consumer sale.<sup>6</sup> Referral selling arrangements are prohibited,<sup>7</sup> as are assignments of earnings,<sup>8</sup> confession of judgments,<sup>9</sup> and garnishment prior to judgment.<sup>10</sup> Various restrictions are placed upon garnishments after judgment,<sup>11</sup> including a provision that no employee shall be discharged because his wages have been garnished.<sup>12</sup>

On the other hand, the Code would do away with the present usury provisions and would leave in their place rates that seem very high. In consumer sales the maximum charges would be either a straight eighteen percent or a varying rate of thirty-six percent on the first \$300, twenty-one percent on the next \$700, and eighteen percent on the remainder up to \$25,000.<sup>13</sup> If the sale were for more than \$25,000 there would be no limitations.<sup>14</sup> On loans, the rates would be eighteen percent unless the lender registered and filed certain forms so as to become a "supervised lender."<sup>15</sup> If the lender went through the formalities of becoming a supervised lender which are only token,<sup>16</sup> the rates would be the same 36%-21%-15% arrangement that is provided for consumer sale transactions.<sup>17</sup> There are no limitations on service charge or loans on sales of over \$25,000.<sup>18</sup> These rates are much higher than those being charged at the present by the vast majority of merchants in consumer credit sales, and substantially higher than the interest rates that any lending institution except small loan companies are allowed to charge. Also the size of the loans allowed are much higher than those presently allowed to small loan companies. Regardless of the fights over the merits of the

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<sup>5</sup> U.C.C.C. § 2.407.

<sup>6</sup> U.C.C.C. § 5.103.

<sup>7</sup> U.C.C.C. § 2.411.

<sup>8</sup> U.C.C.C. §§ 2.410, 3.403.

<sup>9</sup> U.C.C.C. §§ 2.415, 3.407.

<sup>10</sup> U.C.C.C. § 5.104.

<sup>11</sup> U.C.C.C. § 5.105.

<sup>12</sup> U.C.C.C. § 5.106.

<sup>13</sup> U.C.C.C. §§ 2.201, 2.104, 2.602.

<sup>14</sup> U.C.C.C. §§ 2.104, 2.605.

<sup>15</sup> U.C.C.C. § 3.201.

<sup>16</sup> U.C.C.C. § 3.503.

<sup>17</sup> U.C.C.C. § 3.508.

<sup>18</sup> U.C.C.C. §§ 3.104, 3.602.

UCCC on a national basis, the first question for Kentucky consumers must be whether or not the UCCC represents an overall improvement in Kentucky law and secondly, whether or not the same benefits might be obtained without the offsetting problems. In this context it should be pointed out that this article is written strictly from the consumer perspective by an unashamed consumer advocate.

In looking at what the Code would or would not do in connection with Kentucky law, it must first be remembered that the Code only deals with consumer *credit* transactions. It does not purport to be a general consumer fraud law, nor does it do away with the critical need for comprehensive consumer legislation in Kentucky.<sup>19</sup> The Code does regulate the maximum charges on consumer credit sales and loans, place certain limitations on provisions that may be placed in consumer credit contracts and upon creditors' remedies upon default, and prohibit certain practices in connection with consumer credit sales. This article will compare existing Kentucky law with major provisions of the Code, so as to develop a clear picture of the changes that the Code would effect in Kentucky.

#### A QUICK SUMMARY OF THE CODE

The UCCC is divided into nine articles and each article into subdivided parts. Article one is introductory. Article two contains the materials on consumer credit sales, both maximum rates and limitations on agreements. Article three deals with consumer loans. Article four deals with insurance in connection with credit sales. Article five deals with remedies and penalties. Article six deals with administration of the Code. Article seven and eight are reserved for future use. Article nine deals with effective date and repealers.

Articles two and three are the heart of the Code. It is here that the very important distinction between sales and loans is made—

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<sup>19</sup> As noted by Assistant Attorney General of Kentucky, Robert V. Bullock. The UCCC is basically a consumer loan and credit law with incidental consumer protection benefits. These incidental consumer protection benefits cannot be construed as a substitute for consumer fraud or "Little F.T.C. Act" which would normally be enforced by an Attorney General. THE OFFICE OF THE ATTORNEY GENERAL 405 (National Association of Attorneys General Pub., 1971).

article two dealing with sales, and article three dealing with loans. Although there are many parallel provisions between articles two and three, the noticeable absence from the loan article of some of the safeguards provided in the sales article is one of the major flaws of the Code, as will be pointed out later. Other than articles two and three, this paper will only cover article five on remedies.

#### ARTICLE TWO—CONSUMER CREDIT SALES

There are two important aspects to article two. The first is the setting of maximum rates on consumer credit sales. The second is the limitations on consumer credit agreements that are provided. Part two of the article would set maximum limitations on the credit service charge that could be made on consumer credit sales of thirty-six percent on the first \$300, twenty-one percent on the next \$700, and fifteen percent on the remainder up to \$25,000.<sup>20</sup> Above \$25,000 there would be no limits.<sup>21</sup> Part four of the article would prohibit or do away with the effect of certain types of provisions in consumer credit sales contracts. This is where most of the consumer protection aspects of the Code are contained. In addition, part five would provide a three day cooling off period on home solicitation consumer credit sales which would allow a purchaser to cancel a sale made in his home within three days after the agreement.<sup>22</sup>

For the purpose of article two a consumer credit sale is defined as any sale of up to \$25,000 by a person in the business of making such sales to an individual for a "personal, family, household, or agricultural purpose" which is payable in installments, or on which a credit service charge is made.<sup>23</sup> Sales of homes where the interest rate is less than ten percent are excluded.

#### *Maximum Charges on Consumer Credit Sales*

As has been pointed out, part two of article two would provide for limitations on the credit service charge that could be made on consumer credit sales. These limitations would be either a variable

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<sup>20</sup> U.C.C.C. §§ 2.201, 2.104, 2.602.

<sup>21</sup> U.C.C.C. § 2.605.

<sup>22</sup> U.C.C.C. § 2.502.

<sup>23</sup> U.C.C.C. § 2.104.

rate of thirty-six percent on the first \$300, twenty-one percent on the next \$700, and fifteen percent on the remainder, or a straight eighteen percent.<sup>24</sup> It would also provide limitations for the maximum credit service charge on revolving charge accounts, which includes credit cards issued by a merchant for use in his own store as well as open accounts where no credit card is involved.<sup>25</sup> The limitations on revolving charge accounts would be two percent per month up to \$500, and one and one half percent per month on the amount above \$500.<sup>26</sup> The rest of part two deals with closing the loopholes that appear whenever a maximum interest charge is set.<sup>27</sup>

At present under Kentucky law there is no limitation on credit service charges in connection with consumer sales other than automobiles. On automobiles the present limits are nine dollars per hundred on a new car, thirteen dollars per hundred on a two or three year old car, and fifteen dollars per hundred on an older car.<sup>28</sup> Although it would appear obvious that the general usury law would apply in the absence of special statutory provisions, there is a long line of Kentucky cases adopting the time-price differential rule, which holds that it is permissible to have a higher price for goods paid for on credit by charging two distinct prices—one for credit and one for a cash sale—rather than to charge interest on the credit sale.<sup>29</sup> However, to state that there are no limits at present on consumer credit sales in Kentucky would not necessarily indicate that the limits of the Code would necessarily be of benefit to the consumers of Kentucky. In the first place, the time-price differential doctrine, which was at one time almost universally accepted<sup>30</sup> has recently been seriously challenged in many circles. A very recent decision, *State v. J. C. Penney Co.*,<sup>31</sup> has held a revolving credit plan was usurious and

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<sup>24</sup> U.C.C.C. § 2.201.

<sup>25</sup> U.C.C.C. § 1.301(16).

<sup>26</sup> U.C.C.C. § 2.207(3).

<sup>27</sup> U.C.C.C. § 2.202-206, 208-210.

<sup>28</sup> KY. REV. STAT. [hereinafter KRS], § 190.110(1) (Baldwin's 1969).

<sup>29</sup> *Munson v. White*, 217 S.W.2d 641 (Ky. 1949); *Cartwright v. CIT Corp.*, 70 S.W.2d 388 (Ky. 1934); *McAlister v. Gingles*, 50 S.W.2d 551 (Ky. 1932); *Watts v. Nat'l Bldg. & Loan Assn.*, 42 S.W. 839 (Ky. 1897); *Eddy's Ex'r v. Northup*, 23 S.W. 353 (Ky. 1893); *McCann's Ex'r v. Bell*, 79 Ky. 112 (1880); *Gruell v. Smalley*, 62 Ky. (1 Duv.) 359 (1864); *Toussey Robinson*, 58 Ky. (1 Met.) 663 (1859); *Berry v. Walker*, 48 Ky. (9 B. Mon.) 464 (1849).

<sup>30</sup> For a brief history see Comment, *Retail Credit Sales & Usury*, 24 LA. L. REV. 822-42 (1964).

<sup>31</sup> 179 N.W.2d 641 (Wis. 1970).

was not exempted by the time-price doctrine. Challenges are also presently being made in other states. Under these conditions, the time price doctrine is no reason for the consumer to accept extremely high limits as better than no limits.

Furthermore, the limits proposed by the code—thirty-six percent on the first \$300, twenty-one percent on the next \$700, and fifteen percent on the remainder are much higher than those rates presently being charged by retailers in Kentucky. A representative of the retailers recently said in a public committee meeting that the present rate for installment buying in Kentucky is generally eighteen percent with a few merchants charging up to twenty-four percent. Thus, the establishment of a maximum rate of thirty-six percent on the first \$300, which includes most consumer transactions, would allow a rate double that presently being charged. Furthermore, the legalizing of such rates would remove any possibility of general usury rates ever applying via a challenge to the old time-price differential rule.

#### *Limitations on Consumer Credit Sales Contracts*

One of the most important consumer aspects of the UCCC is the limitation on the holder in due course doctrine. This doctrine can be invoked in two ways. Either the consumer sale contract contains a separate negotiable instrument, or it contains a clause which provides that the buyer will waive all defenses that he might have against the seller if the contract is assigned to a third party. The usual situation is a contract with a so-called "waiver of defenses" clause. This has become a standard clause in every consumer contract. Then if the product fails after the contract is assigned, the buyer must continue to make payments to the assignee and seek whatever remedy he may have against the seller. There is usually no effective remedy for the buyer, for one of two reasons, either the seller has skipped town, or the amount involved isn't enough to justify paying a lawyer and litigation expenses.

The Code would attack this problem in two ways. Section 2.403 provides that no seller may take any negotiable instrument other than a check in a consumer credit sale. Section 2.404 offers two alternatives for dealing with the waiver of defense clause problem. Alternative A would simply provide that a waiver of

defense clause is unenforceable, and that any defense can be asserted against the assignee up to the amount owing. Alternative B would do the same thing. However, it would provide that the buyer would have to notify the assignee of defenses existing at the time of the assignment within a certain time after notice of the assignment. But, the waiver of defense clause would still be unenforceable as to any defense arising after the notice period. Either alternative would offer a major improvement over existing law.

The practice of taking a security interest in everything a consumer owns to secure payment of a small debt is a widespread credit abuse. The Code would limit this, but in consumer credit sales only. Section 2.407 provides that a seller can only take a security interest in the property sold, or in personal property to which the item sold is attached if the debt is for \$300 or more, or in real property to which it is attached, if the debt is for \$1,000 or more. Section 2.408 provides for situations where a buyer has purchased two items from the same seller, and allows cross-collateral in that instance, but only if the two sales are treated as if consolidated for the purpose of setting maximum credit service charges. Section 2.409 provides that when the amount owing on the first item is paid off, the security interest on it is released. This prevents the situation where the buyer only owes a small amount, but the seller repossesses everything he has ever sold to the buyer.

The other side of the collateral problem that the Code would cover is the repossessing of the collateral and obtaining of a deficiency judgment. Often when items are repossessed or seized under a security agreement, they are sold for an amount substantially less than their real value, often to the seller or a person acting for the seller. Section 5.103 provides that a seller cannot both repossess and obtain a deficiency judgment where the cash price of the sale was \$1,000 or less.

On the security interest and collateral problem, it must be pointed out that the Code does not touch the problem of a lender taking a security interest in everything the debtor owns to secure a small debt. Nor does it prohibit a lender on default from taking everything a debtor owns, buying it himself at the typical sale at much less than its real value, and then obtaining a deficiency



judgment. In this respect it must be said that the Code is good as far as it goes but that it does not go far enough. In a broader context it must be pointed out that even the protections given become meaningless through the exercise of a simple subterfuge. All of these protections can be nullified by turning the transaction into what is technically a cash sale and a loan, by simply taking the purchaser across the street to a friendly loan company to get a loan in the exact amount of the sale. The proceeds are then turned over to the seller. In fact, under freedom of entry, as is provided by the Code, there would be no need to go across the street. The seller could open his own loan company, and the loan-cash sale could be done on the premises. This is a very serious weakness in the Code. It could be cured by a provision that a lender would be subject to the defenses against the buyer in the case of interlocking sales and loans. Section 2.407 of the National Consumer Act has such a provision.

The cooling-off provision of article two is comprehensive. It would provide that in any transaction where the sale is made by personal solicitation at the buyers' home,<sup>32</sup> the buyer has until the close of the third business day after the sale to rescind the contract.<sup>33</sup> Insurance contracts are excepted by a general definition section.<sup>34</sup> An exception is made for emergencies.<sup>35</sup> This exception may be too broad. The problem involved here is the door-to-door salesman who, imposing upon Americans' natural good manners and hesitancy to be impolite to anyone in their homes, comes into a person's home and gives a high pressured and often fraudulent or misleading sales pitch which results in the individual making a large purchase which he didn't want or need, and often couldn't afford. Further, the products are often seriously overpriced. Every person who has any experience with consumer problems knows of hundreds of such cases, ranging from the "sample encyclopedia pitch," where the homeowner is being told he is being given an encyclopedia and only has to purchase the yearbooks and only later realizes he has signed a contract for several hundred dollars, to the girl on her first job who is talked into buying \$300 worth of pots and pans which could be bought

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<sup>32</sup> U.C.C.C. § 2.501.

<sup>33</sup> U.C.C.C. § 2.502.

<sup>34</sup> U.C.C.C. § 2.105(1).

<sup>35</sup> U.C.C.C. § 2.502(5).

in any store for \$50. There is an acute need for such legislation and its inclusion in the Code is one good feature for the consumer.

The prohibition against referral selling arrangements in the code<sup>36</sup> is a good one, however, it is not new to Kentucky law. KRS 436.360 prohibits such provisions in a contract, and makes entering into such a contract a crime. It also provides for civil remedies upon a suit by the Attorney-General. However, the Code provision might be more effective, since it renders the contract void and allows the buyer to retain the goods without any obligation to pay for them.

#### ARTICLE THREE CONSUMER LOANS

The consumer loan provisions of the Code would employ the rates presently allowed to be charged by petty loan companies on small loans, raise the limitation on the size of loans to \$25,000, and allow all lenders to charge similar rates.<sup>37</sup> The other significant development of the Code in this area is that it would take off almost all restrictions on entering the business of lending money to consumers. The theory for this rather startling change is that with free entry competition will reduce the rates actually charged.

##### *Maximum Rates on Consumer Loans*

The UCCC provides that anyone can lend money at one to eighteen percent per annum.<sup>38</sup> To go above that rate, one simply must obtain a license and become a supervised lender.<sup>39</sup> There are no capital requirements, or requirements of a showing that another lender is needed in the credit market.<sup>40</sup> A supervised lender is allowed to charge rates comparable to those allowed on consumer credit sales, thirty-six percent on the first \$300, twenty-one percent on the next \$700, and fifteen percent on the remainder up to \$25,000.<sup>41</sup> Above \$25,000, or on loans that are not a consumer or consumer related loan, there are no limits.<sup>42</sup> The general usury statutes are repealed.<sup>43</sup>

These rates are fairly comparable to those presently charged

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<sup>36</sup> U.C.C.C. § 2.411.

<sup>37</sup> U.C.C.C. § 3.201.

<sup>38</sup> *Id.*

<sup>39</sup> U.C.C.C. §§ 3.501, .503.

<sup>40</sup> U.C.C.C. § 3.503.

<sup>41</sup> U.C.C.C. § 3.508.

<sup>42</sup> U.C.C.C. § 3.605.

<sup>43</sup> U.C.C.C. § 9.103.

by petty loan companies, twenty dollars per hundred on the first \$300, sixteen dollars per hundred on the next \$500, and thirteen dollars per hundred on the next \$400, or alternatively, three percent per month on the first \$300, two percent per month on the next \$700, and one per cent per month on the next \$1200.<sup>44</sup> A maximum loan size of \$1200 is provided.<sup>45</sup> However, they are substantially higher than the rates presently charged by banks,<sup>46</sup> savings and loan associations,<sup>47</sup> and industrial loans companies<sup>48</sup> on installment loans, which are between eleven and twelve percent on the first \$2,000, and between nine and ten percent on the remainder up to the limits allowed, \$3,500 for savings and loans,<sup>49</sup> \$5,000 for industrial loans,<sup>50</sup> and none for banks.

The various other provisions of the Code to close the loopholes on the actual interest rate charged are substantially paralleled by existing provision in the present Kentucky statutes. As has been pointed out earlier, the Code does not place any limitations on the amount of security that may be taken for a *loan*, or upon taking collateral and also obtaining a deficiency judgment, although such limitations are placed on *sales transactions*.

### *Freedom of Entry*

Freedom of entry would apparently only apply to stock type companies since any kind of institution that accepted money for deposit would still be subject to control.<sup>51</sup> However, under the Code, as written, there would be no prohibition on opening a loan company in any store, or carrying on a loan business in connection with any other kind of business.<sup>52</sup> Whether this would lead to widespread competition and lower rates is not at all clear. The framers of the Code think it will. However, this is a very wide departure from prior thinking on this subject.

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<sup>44</sup> KRS § 288.530.

<sup>45</sup> *Id.*

<sup>46</sup> KRS § 287.215.

<sup>47</sup> KRS § 289.461.

<sup>48</sup> KRS §§ 291.460-.470.

<sup>49</sup> KRS § 289.461.

<sup>50</sup> KRS § 281.470.

<sup>51</sup> U.C.C.C. § 1.108.

<sup>52</sup> U.C.C.C. § 3.512.

## REMEDIES

*Confessions of Judgments and Assignments of Earnings*

As has been pointed out earlier, both article two on sales and article three on loans prohibit provisions in a consumer credit contract calling for either confessions of judgments or assignments of earnings. Although, these are good, the benefit to Kentucky consumers must be considered in light of Kentucky law.

Confession of judgments prior to the filing of an action are illegal under Kentucky law, and have been for some time. KRS 372.140 which has been in effect before the codification of the Kentucky Revised Statutes provides as follows:

(1) Any power of attorney to confess judgement or to suffer judgement to pass by default or otherwise, and any release of errors, *given before an action is instituted, is void.* (emphasis added).

The code would be a little stronger here since there would be no after trial exception.

The situation on assignment of earnings under Kentucky law is not so clear-cut. Assignment of earnings are prohibited with regard to installment loans by banks,<sup>53</sup> savings and loan associations,<sup>54</sup> and industrial loan companies.<sup>55</sup> Their use is allowed by petty loan companies, but with severe restrictions.<sup>56</sup> They are not widely used by small loan companies. In addition, any assignment of earnings of under \$200 is severely restricted by KRS § 371.110-371.140, which requires among other things, the employer's permission, which may be extremely difficult to get. In any event, assignment of earnings is not widely used in Kentucky, even where it is permitted. This provision then would be a theoretical improvement, but without much practical effect.

*Garnishment*

The UCCC has elaborate provisions on garnishment, however, much is parallel to recent federal legislation in this area.

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<sup>53</sup> KRS § 287.215.

<sup>54</sup> KRS § 289.461.

<sup>55</sup> KRS § 291.510.

<sup>56</sup> KRS § 288.570.

Kentucky has adopted almost identical language to the federal law<sup>57</sup> and has obtained an exemption from the operation of the federal act. There would be two substantial changes if the Code were adopted. Rather than the presently restricted pre-judgment garnishment there would be no pre-judgment garnishment at all.<sup>58</sup> Secondly, in lieu of the present provision that an employee cannot be discharged because of the garnishments arising from one debt, there would be a provision that an employee could not be discharged because of any number of garnishments.<sup>59</sup> These undoubtedly would be substantial improvements for the consumers.

### *Unconscionability Clause*

Section 5.108 provides that if a court finds a consumer credit contract or any part of such to be unconscionable it may refuse to enforce the agreement. This provision could be the most advantageous part of the Code to the consumer, since with sympathetic reading by a court it could take care of many existing abuses. This could provide an answer to many abuses associated with consumer sales. However, a similar provision in the Uniform Commercial Code, KRS § 355.2-302, has not lead to any widespread benefits. Also the UCCC would allow the administrator of the Code's provision (the administrator is provided for in article six of the UCCC) to seek an injunction against any person engaging in such contracts on a regular basis.

### CONCLUSION

This summary has not covered some rather important areas of the Code in order to concentrate on those considered most important. Article four on insurance would make some improvements over existing law on the requirement and sale of insurance in connection with credit sales. If the Code were adopted, there are provisions in article six that would become very important, including some rather broad powers in an administrator. I have attempted to survey the major portions of the Code with special

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<sup>57</sup> Ky. Acts ch. 217 (1970). For the federal law see Consumer Credit Protection Act, 15 USC §§ 1671-77 (1968).

<sup>58</sup> Compare KRS § 425.185 and U.C.C.C. § 5.104.

<sup>59</sup> Compare KRS § 425.180 and U.C.C.C. § 5.106.

regard to Kentucky consumers. Whether or not the Code represents enough improvement to offset its liabilities is a decision that consumer groups are going to have to make before the 1972 Session of the General Assembly.